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## **An Equitable Approach to Creditor Noncompliance with Section 9-504(3) of New York's Uniform Commercial Code: Siemens Credit Corp. v. Marvik Colour, Inc.**

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*An equitable approach to creditor noncompliance with section 9-504(3) of New York's Uniform Commercial Code: Siemens Credit Corp. v. Marvik Colour, Inc.*

In the ideal secured transaction, the debtor fulfills its obligation to the secured party by making timely payments. Frequently, however, the debtor defaults on its payments and the secured party is forced to repossess the collateral in which he has a security interest. After repossession, the secured party can either retain the collateral in full satisfaction of the debtor's obligation<sup>1</sup> or sell it and apply the proceeds<sup>2</sup> to the outstanding debt.<sup>3</sup> Under section 9-504(3) of the New York Uniform Commercial Code ("New York Code"), the secured party must give the debtor "reasonable notification of the time and place of any public sale or ... the time after which any private sale" will take place.<sup>4</sup> In addition, all aspects of the sale must be made in a

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<sup>1</sup> N.Y.U.C.C. § 9-501(1) (McKinney 1990). A secured party "may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure." *Id.* A secured party has the right to take possession of the collateral upon default, without judicial process, but only to the extent that repossession can be accomplished without breach of the peace. *Id.* § 9-503. Moreover, if provided in the security agreement, the secured party may require the debtor to assemble the specified collateral and make it available to the secured party at a place that is reasonably convenient for both parties. *Id.*

<sup>2</sup> Proceeds include "whatever is received upon the sale, exchange, collection or other disposition of collateral." N.Y.U.C.C. § 9-306(1) (McKinney 1990). Money, checks, and other deposit accounts are considered "cash proceeds." *Id.*

<sup>3</sup> "A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing." N.Y.U.C.C. § 9-504(1) (McKinney 1990). The disposition of collateral may be done publicly or privately. *Id.* § 9-504(3). For a purchase money security interest involving consumer goods, if the debtor has paid 60% of the cash price, the secured party must dispose of the collateral within 90 days of taking possession. *Id.* § 9-505(1). The debtor has the right, however, to redeem the collateral before the secured party disposes of it. *Id.* § 9-506. The debtor must also fulfill all obligations as to the collateral and reimburse the secured party for all expenses in taking possession, holding, and preparing the collateral for disposition. *Id.* If the secured party does not proceed in disposing of the collateral as outlined in the New York Uniform Commercial Code ("New York Code") the party can be "ordered restrained on appropriate terms and conditions." *Id.* § 9-507(1).

<sup>4</sup> N.Y.U.C.C. § 9-504(3) (McKinney 1990). Notice must also be sent to any other

commercially reasonable manner.<sup>5</sup>

After disposition of the collateral, the debtor is entitled to the surplus of the proceeds over the outstanding debt.<sup>6</sup> If the proceeds are insufficient to repay the indebtedness, the secured party may recover a deficiency judgment from the debtor.<sup>7</sup> In response to the secured party's action for a deficiency judgment, the debtor often asserts that the secured party failed to comply with the notice and reasonableness requirements of section 9-504(3).<sup>8</sup> Upon proof of such a defense, the question becomes

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secured party for which the secured party disposing of the collateral has received written notice of a claim or an interest in the collateral, before notification was sent to the debtor. *Id.* Despite these requirements, the New York Code does not define the term "reasonable notification." *See infra* notes 47-50. The Official Comment to § 9-504, however, gives some indication of the drafters' intent. "[A]t a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire." N.Y.U.C.C. § 9-504 Note 5 at 555 (McKinney 1990). Thus, the notice requirement benefits the debtor because "[w]ith notice the debtor can take steps to assure that the collateral will not be sacrificed for less than its true value and thereby minimize or eliminate any potential deficiency judgment." CHRISTINE A. FERRIS & BENNETT H. GOLDSTEIN, *DISPOSITION OF REPOSSESSED COLLATERAL UNDER THE UNIFORM COMMERCIAL CODE* 32-33 (1990) (footnotes omitted). In essence, notice gives the debtor the opportunity to cause potential bidders to attend the sale which can increase the sale price. ARNOLD B. COHEN, *GUIDE TO SECURED LENDING TRANSACTIONS* ¶ 6.03[2][d], at 6-18 (1988); *see also* *Marine Midland Bank-Rochester v. Vaeth*, 88 Misc. 2d 657, 659-60, 388 N.Y.S.2d 548, 550 (Sup. Ct. Monroe County 1976) (explaining purpose of notice to debtor). In determining whether reasonable notice has been given, all the circumstances surrounding the notice should be examined to determine if the purpose of the notice requirement was furthered or frustrated. *First Bank & Trust Co. v. Mitchell*, 123 Misc. 2d 386, 393, 473 N.Y.S.2d 697, 702 (Sup. Ct. Tompkins County 1984); *see* FERRIS & GOLDSTEIN, *supra*, at 35. Courts may consider such circumstances as the type of sale, sophistication of the parties involved, extent to which the parties have been in contact, physical distances involved, and the nature of the collateral. *Id.* at 77.

<sup>5</sup> N.Y.U.C.C. § 9-504(3) (McKinney 1990). As with the concept of "reasonable notification," the term "commercial reasonableness" is not defined in the New York Code. "The foundation of commercial reasonableness is the actual commercial practice relevant to the particular kind of collateral disposed of at the particular time and place of its disposition." FERRIS & GOLDSTEIN, *supra* note 4, at 3.

<sup>6</sup> N.Y.U.C.C. § 9-504(2) (McKinney 1990). If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus upon sale. *Id.* "But if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus ... only if the security agreement so provides." *Id.*

<sup>7</sup> *Id.* If the underlying transaction involves a sale of accounts or chattel paper, the debtor is liable for any deficiency only if such a remedy is provided the secured party in the security agreement. *Id.*

<sup>8</sup> *See, e.g.,* *Hoch v. Ellis*, 627 P.2d 1060, 1062 (Alaska 1981) (finding defendant's sale of repossessed collateral deficient because there was no notification of sale); *Universal C.I.T. Credit Co. v. Rone*, 453 S.W.2d 37, 39 (Ark. 1970) (acknowledging distinction between counterclaims and affirmative actions under § 9-507(1) and us-

whether the secured party remains entitled to a deficiency judgment in the absence of any express rule in the New York Code. Federal and state courts throughout the country are split on this issue, but have generally adopted one of three approaches.<sup>9</sup>

In addition to division among the states, the departments of the Appellate Division of the Supreme Court of New York also disagree about which of the approaches is correct. The Second Department imposes an "absolute bar" to recovery of a deficiency judgment if the secured party fails to comply with section 9-504(3).<sup>10</sup> The Third Department applies a "setoff" approach in which the debtor must prove the amount of any damages sustained due to the secured party's noncompliance; the deficiency judgment is thereafter reduced by the amount of such damages.<sup>11</sup> The First and Fourth Departments hold that noncompliance creates a "rebuttable presumption" that the fair market value of the collateral is equal to the outstanding debt thereby shifting the burden of proving the deficiency to the secured party.<sup>12</sup> Recently,

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ing noncompliance with § 9-504(3) as defense); *Alliance Discount Corp. v. Shaw*, 171 A.2d 548, 549 (Pa. Super. Ct. 1961) (averring as defense plaintiff's failure to comply with § 9-504(3)).

<sup>9</sup> The strictest approach imposes an absolute bar to a deficiency judgment for a secured party's noncompliance with the statute. *See, e.g.*, *Chittenden Trust Co. v. Andre Noel Sports*, 621 A.2d 215, 219 (Vt. 1992); *see also infra* notes 70-82 and accompanying text (discussing "absolute bar" approach). The second approach mandates that the debtor prove any damages caused by noncompliance and "set-off" the deficiency judgment to that extent. *See, e.g.*, *Chapman v. Field*, 602 P.2d 481, 485 (Ariz. 1979); *see also infra* notes 83-94 and accompanying text (discussing "set-off" approach). The third method constructs a rebuttable presumption that the value of the collateral was equal to the debt. *See, e.g.*, *Bank of Chapmanville v. Workman*, 406 S.E.2d 58, 64 (W. Va. 1991); *see also infra* notes 95-107 and accompanying text (discussing "rebuttable presumption" approach). *See generally* FERRIS & GOLDSTEIN, *supra* note 4, at 5 (discussing lack of uniformity in law with respect to disposition of collateral); Michael Vanderford, Note, *Secured Transactions in Arkansas*, *Bank of Bearden v. Simpson: Living with Both the Rebuttable Presumption and the Absolute Bar*, 46 ARK. L. REV. 475, 478-79 (1993) (discussing approaches to noncompliance of § 9-504(3)).

<sup>10</sup> *E.g.*, *Central Budget Corp. v. Garrett*, 48 A.D.2d 825, 368 N.Y.S.2d 268 (2d Dep't 1975); *Long Island Bank v. Knight*, 122 Misc. 2d 878, 473 N.Y.S.2d 901 (App. Term 2d and 11th Jud. Dists. 1983); *see also infra* notes 70-82 and accompanying text (discussing absolute bar rule).

<sup>11</sup> *E.g.*, *Stanchi v. Kemp*, 48 A.D.2d 973, 370 N.Y.S.2d 26 (3d Dep't 1975); *see also* N.Y.U.C.C. § 9-507(1) (McKinney 1990); *infra* notes 83-94 and accompanying text (discussing setoff rule). *See generally* Kathryn Page, *A Secured Party's Right to a Deficiency Judgment After Noncompliance with the Resale Provisions of Article 9*, 60 N.D. L. REV. 531, 535 (1984) (discussing same).

<sup>12</sup> *E.g.*, *Telmark, Inc. v. Lavigne*, 124 A.D.2d 1055, 508 N.Y.S.2d 737 (4th Dep't 1986); *General Elec. Credit Corp. v. Durante Bros. & Sons, Inc.*, 79 A.D.2d 509, 433 N.Y.S.2d 574 (1st Dep't 1980); *Security Trust Co. v. Thomas*, 59 A.D.2d 242, 399

in *Siemens Credit Corp. v. Marvik Colour, Inc.*,<sup>13</sup> the United States District Court for the Southern District of New York applied a combination of the rebuttable presumption and setoff rules in holding that a creditor's noncompliance with the statutory provisions of the Uniform Commercial Code does not absolutely bar a deficiency judgment;<sup>14</sup> instead, at trial the secured party must rebut the presumption that fair market value equals the outstanding debt, while the debtor is entitled to any damages it proves as a result of noncompliance with section 9-504(3).<sup>15</sup>

In *Siemens Credit*, Siemens Credit Corporation ("Siemens") was the assignee of a security agreement ("Agreement") between Marvik Colour, Inc. ("Marvik") and Linotype-Hell Graphic ("Linotype") in connection with Marvik's purchase of a computer system from Linotype.<sup>16</sup> The Agreement granted Linotype a purchase money security interest in the computer system.<sup>17</sup> Marvik defaulted on the payments under the Agreement and Siemens filed an action to recover the past due amounts.<sup>18</sup> Siemens demanded the return of the computer system from Marvik, but Marvik refused.<sup>19</sup> Eventually, Marvik complied with Siemens' request, and Linotype, acting as Siemens' agent, refurbished the system and sold it for an amount less than the full amount of the outstanding debt.<sup>20</sup> Siemens sought recovery of the deficiency,<sup>21</sup>

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N.Y.S.2d 511 (4th Dep't 1977); see also *infra* notes 95-107 and accompanying text (discussing rebuttable presumption approach).

<sup>13</sup> 859 F. Supp. 686 (S.D.N.Y. 1994).

<sup>14</sup> *Id.* at 692.

<sup>15</sup> *Id.* at 693.

<sup>16</sup> *Id.* at 690.

<sup>17</sup> *Id.* A purchase money security interest is one that is "taken or retained by the seller of the collateral to secure all or part of its price." N.Y.U.C.C. § 9-107(a) (McKinney 1990); see *Heidelberg Eastern, Inc. v. Weber Lithography Inc.*, 213 A.D.2d 127, 129, 631 N.Y.S.2d 370, 372 (2d Dep't 1995) (discussing transaction in which seller maintained purchase money security interest in printing press).

<sup>18</sup> *Siemens Credit*, 859 F. Supp. at 690. After Marvik filed its answer, it commenced a third party action against Linotype for breach of contract, warranty, negligence, and fraud. *Id.*

<sup>19</sup> *Id.* Marvik would not return the computer system until Siemens refunded Marvik's \$50,000 down payment and compensated Marvik for \$100,000 installation costs. *Id.* Siemens responded by making a motion to compel Marvik to pay for its continued use of the computer system. Eventually, Marvik returned the equipment to Siemens. *Id.* at 690-91.

<sup>20</sup> *Siemens Credit*, 859 F. Supp. at 691. The parties stipulated that Siemens could dispose of the collateral in any way consistent with the Agreement or the New York Code. *Id.*

<sup>21</sup> *Id.*; see *supra* note 6 and accompanying text (discussing § 9-504(2) which makes debtor liable for deficiency resulting from sale). Under New York Code § 9-504(2),

but Marvik claimed that since Siemens did not notify Marvik of the sale, Siemens lost its right to a deficiency judgment.<sup>22</sup> Marvik's argument was based on New York Code section 9-504(3) which expressly requires the secured party to provide reasonable notification of sale to the debtor.<sup>23</sup>

The *Siemens Credit* court held that Siemens was entitled to a deficiency judgment subject to its ability at trial to rebut the presumption that the equipment's fair market value was equal to the amount of the outstanding debt.<sup>24</sup> The court additionally held that Marvik was entitled to damages for the failure of notification.<sup>25</sup> In so holding, the court combined the rebuttable presumption and setoff rules for what it felt was the best balance of the competing interests of the debtor and creditor.<sup>26</sup> The court reasoned that while the chosen remedy should deter the secured party from violating the statutory requirements of section 9-504(3), the creditor should not be unfairly penalized, thereby rewarding the debtor.<sup>27</sup>

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the debtor is liable to the secured party for any deficiency resulting from a disposition of collateral after repossession. N.Y.U.C.C. § 9-504(2) (McKinney 1990).

<sup>22</sup> The court later noted that Marvik was not harmed by the lack of notice since the system was returned to Siemens with the understanding that it was to be sold. *Siemens Credit*, 859 F. Supp. at 693. In light of this fact, the court felt that application of the absolute bar rule would be unduly harsh to Siemens. *Id.*

<sup>23</sup> *Id.* at 691; see *supra* note 4 and accompanying text (discussing reasonable notice requirement of § 9-504(3)).

<sup>24</sup> *Siemens Credit*, 859 F. Supp. at 693.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 692. The court began its discussion by noting that the New York Code does not specifically provide a remedy for noncompliance with § 9-504(3) and that the New York Court of Appeals has not yet addressed this gap in the Code. *Id.* at 691. The court, however, did mention that the Court of Appeals would likely allow a debtor in Marvik's position to prove damages resulting from lack of notice because the New York courts seek to protect the economic interests of those who do business in the state. *Id.* at 693. In addition, the court cited to the Seventh Circuit's prediction that the New York Court of Appeals would adopt the rebuttable presumption test. *Id.* at 692; see *In re Excello Press Inc.*, 890 F.2d 896, 903 (7th Cir. 1989) (applying New York law in bankruptcy appeal). The court also acknowledged the split of authority among the New York Appellate Division Departments. *Siemens Credit*, 859 F. Supp. at 691; see *supra* notes 10-12 and accompanying text (discussing split in New York). The court further stated that when determining which of the three existing rules to apply, a court should attempt to balance the interests of the debtor and creditor in a manner which would protect the debtor, yet be fair to the creditor. *Id.* at 690.

<sup>27</sup> *Id.* In rejecting the absolute bar approach, the *Siemens Credit* court felt that it was disproportionately harsh to the secured party because it completely deprives the secured party of money which it is rightfully owed, often because of a minor oversight. *Id.*; see also *Security Sav. Bank v. Tranchitella*, 592 A.2d 284, 285 (N.J. Super. Ct. App. Div. 1991) (explaining that "absolute bar" does not fairly balance

In choosing to combine the rebuttable presumption and set-off rules, the court stated that "[u]nder this scheme, the secured party does not lose the entire value of the deficiency ... , [yet is] deter[red] ... from flouting the requirements of § 9-504(3)."<sup>28</sup> In addition, the court asserted that New York Code section 9-507(1) is a "statutory embodiment and endorsement of the setoff rule[;]"<sup>29</sup> thus, the rebuttable presumption and setoff rules should be applied together.<sup>30</sup>

It is submitted that New York state courts faced with the question of whether a noncomplying creditor under section 9-504(3) is nonetheless entitled to a deficiency judgment should follow the reasoning of the *Siemens Credit* court. The combination of the rebuttable presumption and setoff rules balances the interests of both the debtor and creditor while furthering the goals and policies of the New York Code.

Part I of this Article will trace the development of secured transactions law in New York from the Uniform Conditional Sales Act to the Uniform Commercial Code. Part II will describe the three approaches currently employed by New York courts and explain why the path taken by the *Siemens Credit* court is the most equitable. Part III suggests an amendment to the New York Code that would codify the approach taken by the Southern District in *Siemens Credit* and eradicate the current split among New York state courts. Such an amendment would establish a rule which courts may apply uniformly and practitioners may utilize to better serve their clients.

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interests of parties). The *Siemens Credit* court explained that this approach results in a windfall for the debtor because he is completely absolved of responsibility for repayment of his obligation. *Siemens Credit*, 859 F. Supp. at 692. The court also discounted the application of the setoff rule alone for the simple reason that "it does not adequately protect the debtor's right to notification." *Id.* (citations omitted).

<sup>28</sup> *Siemens Credit*, 859 F. Supp. at 692. The court noted the rebuttable presumption rule will force the secured party to bear the loss if the collateral is sold at below market value, and the debtor will not have to pay any more than it would have paid had proper notice been given. *Id.* The secured party will, in turn, be encouraged to comply with the statutory requirements to avoid having to come forward with evidence to rebut the presumption that the fair market value of the collateral equals the amount of the outstanding debt. *Id.*

<sup>29</sup> *Id.* at 693.

<sup>30</sup> *Id.* at 693. In what perhaps may be the most important line of its decision, the court explicitly states: "[A]doption of the rebuttable presumption rule does not preclude application of the setoff rule." *Id.*

## I. SECURED TRANSACTIONS LAW IN NEW YORK

### A. *The Development of Secured Transactions Law*

Prior to the adoption of the Uniform Commercial Code in New York, the relationship between debtors and creditors was governed by the Uniform Conditional Sales Act ("U.C.S.A.").<sup>31</sup> The requirements for repossession and subsequent disposition of collateral under the U.C.S.A. were very rigid and explicit.<sup>32</sup> Like the current law, the seller was required to return to the buyer any surplus from the sale and the buyer remained accountable to the seller for any deficiency.<sup>33</sup> The only provision in the old law which dealt with a seller's noncompliance with the repossession and disposition rules was section 80-e, which provided for actual damages.<sup>34</sup> Despite this provision, case law held that if the resale was not conducted in strict compliance with the statutory requirements, the seller was absolutely barred from recovering

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<sup>31</sup> The counterpart to present-day Part 5 of Article 9 was sections 76 to 80-e of the U.C.S.A. Uniform Conditional Sales Act, ch. 642, §§ 60 to 80-j, [1922] N.Y. Laws 1766 (repealed 1964).

<sup>32</sup> Generally speaking, the secured party was entitled to repossess the collateral upon the debtor's default. *Id.* § 76. Section 77 required the secured party to serve upon the buyer a notice of intention to retake. *Id.* § 77. This placed the burden upon the buyer to perform the obligations under the conditional sales agreement. *Id.* Failure to do so allowed the seller to retake the goods. *Id.* Section 78 applied when the seller did not serve such notice of intention upon the buyer and required the seller in that instance to retain the goods for 10 days during which period the buyer had the right to redeem the collateral. *Id.* § 78 [1922] N.Y. Laws 1766 (repealed 1964). Subject to some rigorous requirements contained in § 79, the secured party could also resell the collateral in an attempt to recoup the outstanding balance of the debt. *Id.* § 79. Section 79 noted that if the buyer did not redeem within the first 10 days after repossession, and the buyer had paid over 50% of the purchase price, the seller was compelled to sell the collateral at a public sale. *Id.* If the buyer had paid less than 50% of the price, § 80 allowed the parties to opt to resell the collateral. *Id.* § 80; *see Snyder v. Guider*, 17 Misc. 2d 558, 561, 185 N.Y.S.2d 110, 114-15 (Sup. Ct. Erie County 1959) (describing method by which U.C.S.A. provided for resale of collateral upon debtor's default).

<sup>33</sup> Uniform Conditional Sales Act, ch. 642, § 80-b, [1922] N.Y. Laws 1773 (repealed 1964) (giving seller right to recover deficiency judgment); *cf.* N.Y.U.C.C. § 9-504(2) (McKinney 1990).

<sup>34</sup> Uniform Conditional Sales Act, ch. 642, § 80-e [1922] N.Y. Laws 1773 (repealed 1964) (providing that "buyer [could] recover from the seller his actual damages" resulting from such noncompliance); *cf.* N.Y.U.C.C. § 9-507(1) (McKinney 1990); *see Squazzo v. Timken Silent Automatic Co.*, 249 A.D. 757, 291 N.Y.S. 945 (2d Dep't 1936) (acknowledging that buyer who has paid more than 50% of purchase price when property is retaken by seller is entitled to damages under § 80-e).



any deficiency.<sup>35</sup>

Many of the detailed requirements of the U.C.S.A. were abolished by the adoption of the Uniform Commercial Code ("Uniform Code") in 1964. The Uniform Code was heralded as "a general and comprehensive revision of the state's existing laws applicable to commercial transactions."<sup>36</sup> The Official Comment to section 9-101 notes that the purpose of Article 9 is to create a simple, uniform structure which would enable the complicated financial transactions of the commercial world to be carried out with "less cost and greater certainty."<sup>37</sup> The goal of the disposition provisions of the Uniform Code is to maximize recovery from

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<sup>35</sup> *Manufacturers Hanover Trust Co. v. Goldstein*, 25 A.D.2d 405, 407, 270 N.Y.S.2d 261, 263 (1st Dep't 1966). In *Manufacturers Hanover*, a conditional buyer purchased an air conditioner from a conditional vendor pursuant to a retail installment contract and promissory note. *Id.* at 407, 270 N.Y.S.2d at 263. The conditional buyer defaulted on his installment payments for March and April 1962, and the vendor repossessed the air conditioner on May 22, 1962. *Id.* The vendor sold the air conditioner at a public sale on June 1 after having given the debtor notice on May 22. *Id.* Citing § 78 of the U.S.C.A., the court noted that the vendor was required to hold onto the repossessed goods for 10 days after the repossession in order to give the buyer the chance to redeem. *Id.*, 270 N.Y.S.2d at 264. Section 78 was interpreted to mean that the sale could not occur until the 11th day, *id.* at 407, 270 N.Y.S.2d at 264, and since the sale occurred on the 10th day, it was not in compliance with § 78. *Id.* Since the sale was not in compliance with the requirements of the statute, the vendor was held to have lost his right to a deficiency judgment. *Id.* at 407, 270 N.Y.S.2d at 263; *accord* *Warren-Joel Corp. v. Kirschenbaum*, 57 Misc. 2d 451, 454, 292 N.Y.S.2d 791, 794 (Sup. Ct. App. Term 1st Dep't 1968) (holding that seller's failure to give notice as required by § 78 precludes recovery of deficiency judgment from buyer), *aff'd*, 31 A.D.2d 1005, 299 N.Y.S.2d 780 (1st Dep't 1969); *see also* *Mott v. Moldenhauer*, 261 A.D. 724, 727, 27 N.Y.S.2d 563, 566 (3d Dep't) (holding that seller's failure to give notice discharged buyer of any obligation under agreement), *appeal dismissed*, 287 N.Y. 678, 39 N.E. 293 (1941); *Leasco Computer, Inc. v. Sheridan Indus.*, 82 Misc. 2d 897, 900, 371 N.Y.S.2d 531, 533 (N.Y. Civ. Ct. N.Y. County 1975) (acknowledging that under U.C.S.A., failure to comply with § 79 discharged buyer from any obligations under agreement). Other state courts have held that strict compliance with the requirements of the U.C.S.A. is a condition precedent to obtaining a deficiency judgment from the debtor. *See, e.g.,* *Rushton v. Shea*, 423 F. Supp. 468, 470-71 (D. Del. 1976); *Atlas Thrift Co. v. Horan*, 104 Cal. Rptr. 315, 320-21 (Cal. Ct. App. 1972); *Chittenden Trust Co. v. Maryanski*, 415 A.2d 206, 210 (Vt. 1980).

<sup>36</sup> *Leasco Computer*, 82 Misc. 2d at 899, 371 N.Y.S.2d at 533 (citation omitted); *see also* Edward S. Godfrey, *Preview of the Uniform Commercial Code*, 16 ALB. L. REV. 22, 36 (1952) (noting that Article 9 is "much more than a codification of existing law").

<sup>37</sup> N.Y.U.C.C. § 9-101 Note at 291 (McKinney 1990); *see also* Page, *supra* note 11, at 541 (discussing goal of flexibility within Code); *Panel Discussion on the Uniform Commercial Code: Report of the New York Law Revision Commission - Areas of Argument and Disagreement*, 12 BUS. LAW. 49, 53 (1956) ("Article 9 attempts to provide flexibility and certainty now lacking.").

the sale to benefit all persons involved.<sup>38</sup> A simple comparison of the provisions of the U.C.S.A. with the provisions of Part 5 of Article 9 demonstrates that much of the detailed and rigid requirements for resales have been replaced by more flexible, informal procedures.<sup>39</sup> For example, pursuant to section 79 of the U.C.S.A., a seller had to concern itself with how much of the purchase price the buyer had already paid in determining whether to conduct a private or public sale;<sup>40</sup> in contrast, New York Code section 9-504(3)'s only requirements are those of reasonable notification and commercially reasonable behavior.<sup>41</sup> Under the New York Code, the secured party is accorded much more flexibility in conducting its resale.

*B. The Secured Party's Right to Repossess and Dispose of Collateral After Default*

New York Code section 9-504(1) provides that a secured party "may sell, lease or otherwise dispose of any or all of the collateral" upon the debtor's default.<sup>42</sup> By choosing not to exercise this statutory right, the secured party has the option to seek a judgment through judicial process and levy upon the debtor's property.<sup>43</sup> If the secured party opts to repossess the collateral, section 9-504(2) requires that the secured party return any surplus to the debtor following the sale and makes the debtor accountable to the secured party for any deficiency.<sup>44</sup> Section 9-

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<sup>38</sup> FERRIS & GOLDSTEIN, *supra* note 4, at 2.

<sup>39</sup> See *Leasco Computer*, 82 Misc. 2d at 899, 371 N.Y.S.2d at 533 (citing U.C.C.'s elimination of U.S.C.A.'s requirement that buyer retain goods for 10 days); *Conti Causeway Ford v. Jarossy*, 276 A.2d 402, 404 (N.J. Dist. Court Ocean County 1971) (noting that U.C.C. does not set forth specific time period when notice must be given), *aff'd*, 288 A.2d 872 (N.J. Super. Ct. App. Div. 1972).

<sup>40</sup> If the buyer had paid at least 50% of the purchase price then the seller would have to conduct a public auction. Uniform Conditional Sales Act, ch. 642, § 79 [1922], N.Y. Laws 1766 (repealed 1964).

<sup>41</sup> See N.Y.U.C.C. § 9-504(3) (McKinney 1990).

<sup>42</sup> N.Y.U.C.C. § 9-504(1) (McKinney 1990).

<sup>43</sup> N.Y.U.C.C. § 9-503 (McKinney 1990). If the secured party chooses to use judicial process, the situation will no longer be governed by the default provisions of Article 9, but by any available procedure provided by state law. See *S.M. Flickinger Co. v. 18 Genesee Corp.*, 71 A.D.2d 382, 386, 423 N.Y.S.2d 73, 76 (4th Dep't 1979).

<sup>44</sup> N.Y.U.C.C. § 9-504(2) (McKinney 1990). A deficiency is "the difference between the remaining indebtedness on the conditional sales contract plus incidental and authorized expenses and the amount realized on a private sale of the [collateral] following its repossession." *General Elec. Credit Corp. v. Durante Bros. & Sons, Inc.*, 79 A.D.2d 509, 509, 433 N.Y.S.2d 574, 575 (1st Dep't 1980). The deficiency may include expenses of repossession, transfer, and storage of the collateral. See *First City*

504(3) protects the debtor by placing limitations upon the secured party's resale of the repossessed collateral.<sup>45</sup> Not only must the secured party send the debtor reasonable notice of the sale, but every aspect of the disposition must be commercially reasonable.<sup>46</sup>

The notification requirement protects the debtor from unscrupulous creditors by allowing the debtor the opportunity either to participate in the sale or to redeem the collateral.<sup>47</sup> The

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Div. of Chase Lincoln First Bank, N.A. v. Vitale Lumber Co., Inc., 123 A.D.2d 207, 213, 510 N.Y.S.2d 766, 770 (3d Dep't 1987) (concluding that creditor's expenses were "chargeable toward the deficiency").

<sup>45</sup> N.Y.U.C.C. § 9-504(3) (McKinney 1990). This section provides in pertinent part: Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but *every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable*. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, *reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor ....*"

*Id.* (emphasis added); see also JAMES WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 25-10, at 925 (4th ed 1995) ("The theory of notice is to give the debtor an opportunity either to discharge the debt and redeem the collateral ... or to see that the sale is conducted in a commercially reasonable manner.").

<sup>46</sup> See N.Y.U.C.C. § 9-504(3) (McKinney 1990); see also *supra* note 45 (providing language of § 9-504(3)). The secured party is also constrained by § 1-203 which requires that it act in good faith. N.Y.U.C.C. § 1-203 (McKinney 1990) ("Every contract or duty within the Act imposes an obligation of good faith in its performance or enforcement."); see N.Y.U.C.C. § 9-507 Official Comment at 577 (McKinney 1990) (stating that principal limitation on secured party's right to dispose of collateral is good faith); FERRIS & GOLDSTEIN, *supra* note 4, at 142-43 ("Th[e] duty of good faith has been variously described as the duty to act to protect the debtor's interests as well as the creditor's ... [and] to use best efforts to obtain the best price ...."). The burden of proving compliance with the requirements of § 9-504(3) rests with the secured party. See *European Am. Bank v. Kahn*, 175 A.D.2d 704, 708, 573 N.Y.S.2d 274, 277 (1st Dep't 1991); *Bancamerica Private Brands, Inc. v. Marine Gallery, Inc.*, 157 A.D.2d 813, 550 N.Y.S.2d 720, 720-21 (2d Dep't 1990); *FDIC v. Forte*, 144 A.D.2d 627, 628, 535 N.Y.S.2d 75, 77 (2d Dep't 1988); *Mack Fin. Corp. v. Knoud*, 98 A.D.2d 713, 713-14, 469 N.Y.S.2d 116, 117 (2d Dep't 1983); see also FERRIS & GOLDSTEIN, *supra* note 4, at 148 (noting burden of proving commercial reasonableness is on secured party in "overwhelming majority of jurisdictions").

<sup>47</sup> *Chandler Leasing Corp. v. Durante Bros. & Sons, Inc.*, 24 U.C.C. Rep. Serv. 804, 806 (N.Y. Sup. Ct. Queens County 1978). The court in *Chandler Leasing* wrote: [The purpose of notice to the debtor of the sale of the collateral] is to enable the debtor to protect his interest in the property by paying the debt, finding a buyer or being present at the sale ... to the end that [the property not be] sacrificed by a sale at less than its true value.

*Id.*; see *Rushton v. Shea*, 423 F. Supp. 468, 469 (D. Del. 1976) (discussing purpose of notice requirement); *First Bank & Trust Co. v. Mitchell*, 123 Misc. 2d 386, 393, 473 N.Y.S.2d 697, 702 (Sup. Ct. Tompkins County 1984) ("All of the circumstances sur-

debtor is strictly prohibited from waiving this right.<sup>48</sup> Although "reasonable notice" is not defined by the New York Code, notification prior to the sale which gives the debtor sufficient time to protect its interest in the collateral is considered reasonable.<sup>49</sup> Notice is unnecessary, however, if the "collateral is perishable or threatens to decline speedily in value" or is sold on a recognized market.<sup>50</sup> Absent these exceptions, notice is generally required for the proper disposition of secured collateral.

The requirement that "every aspect of the disposition ... must be commercially reasonable" further limits the secured party's right to resell the collateral.<sup>51</sup> Since the term

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rounding the giving of notice must be evaluated in light of the purpose of the notice requirement ... ."); see also *Holt v. Peoples Bank*, 814 S.W.2d 568, 570 (Ky. 1991) (noting that it is not clear whether failure of secured party to act in commercially reasonable manner requires denial of deficiency judgement); *Franklin State Bank v. Parker*, 346 A.2d 632, 635 (N.J. Dist. Ct., Union County 1975) (stating commercially reasonable conduct should be consistent with "prevailing trade practices"). For a description of the notice requirements see FERRIS & GOLDSTEIN, *supra* note 4, at 31-35; cf. WHITE & SUMMERS, *supra* note 45, at 925 (suggesting that rationale and utility of notice requirement is dubious and that it leads to illogical result of letting debtors escape from debts). See generally Maury B. Poscover, *A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair to all Involved*, 28 LOY. L.A. L. REV. 235, 238-41 (1994) (discussing Article 9 requirements of commercial reasonableness and notice). Section 9-506 establishes the debtor's right to redeem collateral. N.Y.U.C.C. § 9-506 (McKinney 1990) ("[T]he debtor ... may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party ...."). Since the right to redemption exists only before disposition of the collateral, timely notification is extremely important. *Fitzpatrick v. Bank of N.Y.*, 125 Misc. 2d 1069, 1074, 480 N.Y.S.2d 864, 868 (N.Y. Civ. Ct. Queens County 1984).

<sup>48</sup> N.Y.U.C.C. § 9-501(3) (McKinney 1990); see *Mitchell*, 123 Misc. 2d at 389, 473 N.Y.S.2d at 701 (refusing to recognize contractual provision waiving statutory notice); *Marine Midland Bank-Central v. Watkins*, 89 Misc. 2d 949, 951, 392 N.Y.S.2d 819, 821 (Sup. Ct. Onondaga County 1977) (noting requirement of notice cannot be "waived or varied"); accord *C.I.T. Corp. v. Haynes*, 212 A.2d 436, 438 (Me. 1965) (stating antecedent waiver of notification right is void as against public policy).

<sup>49</sup> See *In re Excello Press, Inc.*, 890 F.2d 896, 902 (7th Cir. 1989) (discussing reasonable notification).

<sup>50</sup> N.Y.U.C.C. § 9-504(3) (McKinney 1990); see, e.g., *Chittenden Trust Co. v. Andre Noel Sports*, 621 A.2d 215, 218 (Vt. 1992) (noting that debtor does not need protection of notice under recognized market exception because "independent market forces set the sale price which is presumptively commercially reasonable").

<sup>51</sup> N.Y.U.C.C. § 9-504(3) (McKinney 1990). The term "commercially reasonable" is not defined in the New York Code. See FERRIS & GOLDSTEIN, *supra* note 4, at 140. Commercial reasonableness is a question of fact to be determined on a case by case basis. *Id.*; see *FDIC v. Forte*, 144 A.D.2d 627, 628, 535 N.Y.S.2d 75, 77 (2d Dep't 1988). In *Forte*, the court concluded that the sale was not commercially reasonable on the basis of three factors: (1) the actual circumstances surrounding the sale; (2)

"commercially reasonable" is not explicitly defined in the New York Code, courts have established two tests to determine compliance with this statutory requirement:<sup>52</sup> (1) the "procedures test," which focuses on the specific procedures used in an attempt to obtain a fair price;<sup>53</sup> and (2) the "proceeds test," which requires the secured party to act in a manner which will obtain the highest possible price.<sup>54</sup> The plain language of section 9-507(2) seems to support the procedures test: "[T]he fact that a better price could have been obtained ... is not of itself sufficient

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the fact that a year had elapsed between foreclosure; and (3) the substantial discrepancy between the sale price and the fair market value of the property. *Id.* Another jurisdiction has noted that evidence which would demonstrate commercial reasonableness includes "the amount of advertising done, the number of people contacted, normal commercial practices in disposing of the particular collateral, the length of time between the repossession and the sale, whether any deterioration in the collateral has occurred, the number of bids received, and the price obtained." *Connecticut Bank & Trust Co. v. Incendy*, 540 A.2d 32, 39 (Conn. 1988); *see also* *General Elec. Credit Corp. v. Durante Bros. & Sons, Inc.*, 79 A.D.2d 509, 510, 433 N.Y.S.2d 574, 576 (1st Dep't 1980) (concluding that secured party's failure to inspect equipment or acknowledge its special option features was commercially unreasonable).

<sup>52</sup> *See Kohler v. Ford Motor Credit Co., Inc.*, 93 A.D.2d 205, 208, 462 N.Y.S.2d 297, 300 (3d Dep't 1983) (noting courts are split on whether commercial reasonableness "turns on the actual procedures employed or whether the prime objective is optimizing the resale price"); *see also In re Excello Press, Inc.*, 890 F.2d 896, 905-06 (7th Cir. 1989) (discussing two approaches to commercial reasonableness); *Bankers Trust Co. v. J. V. Dowler & Co., Inc.*, 47 N.Y.2d 128, 135, 390 N.E.2d 766, 769, 417 N.Y.S.2d 47, 51 (1979) (comparing test which focuses on price with one that focuses on procedure). Article 9 also identifies several general indicators of commercial reasonableness. N.Y.U.C.C. § 9-507(2) (McKinney 1990). The listed indicators of commercial reasonableness are not, however, "to be regarded as either required or exclusive." N.Y.U.C.C. § 9-507 Official Comment 2, at 578 (McKinney 1990); *see also* 9A RONALD A. ANDERSON, *ANDERSON ON THE UNIFORM COMMERCIAL CODE* 9-507:3 (1994 Revision of Vol. 9) (suggesting that object of Code and commercial reasonableness requirement is to "encourage the making of the most advantageous sale in order to reduce the deficiency for which the debtor is liable.").

<sup>53</sup> *See, e.g., Leasing Serv. Corp. v. First Tenn. Bank, N.A.*, 826 F.2d 434, 439 (6th Cir. 1987) ("A commercially reasonable sale is tested by the procedures employed for sale rather than the proceeds received."); *Franklin State Bank v. Parker*, 346 A.2d 632, 635 (N.J. Super. 1975) (noting that seller should have at least made casual inspection of automobile before reselling it to determine why it did not operate); *FDIC v. Herald Square Fabrics Corp.*, 81 A.D.2d 168, 184, 439 N.Y.S.2d 944, 954 (2d Dep't 1981) (discussing procedures test); *see also FERRIS & GOLDSTEIN, supra* note 4, at 152-53 (stating that procedures test is most frequently used, but proceeds test is also available).

<sup>54</sup> *See, e.g., John Deere Indus. Equip. Co. v. Triple Cities Equip., Inc.*, 646 F. Supp. 114, 117 (N.D.N.Y. 1986); *Herald Square Fabrics*, 81 A.D.2d at 184, 439 N.Y.S.2d at 954; *see also FERRIS & GOLDSTEIN, supra* note 4, at 153 (indicating that courts that treat price as "key component" in deciding commercial reasonableness are employing proceeds test).

to establish that the sale was not made in a commercially reasonable manner."<sup>55</sup> Under either formulation, a substantial discrepancy between the original purchase price and the disposition price will invite closer scrutiny by the court.<sup>56</sup> Apart from considering the resale price, commercial reasonableness requires that the secured party make a timely disposition of the collateral after repossession.<sup>57</sup>

In order to facilitate determination of this fact-intensive issue, section 9-507(2) establishes situations in which a disposition will be considered commercially reasonable: (1) when the secured party sells the collateral in a recognized market; (2) when the secured party sells in conformity with reasonable commercial practices among dealers in the type of collateral being sold; or (3) when it sells in a disposition which has been approved in a judicial proceeding.<sup>58</sup> These situations are neither exclusive nor required, so long as the secured party can in fact establish

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<sup>55</sup> N.Y.U.C.C. § 9-507(2). In *In re Zsa Zsa Ltd.*, 352 F. Supp. 665, 671 (S.D.N.Y. 1972), *aff'd*, 475 F.2d 1393 (2d Cir. 1973), the court stated that:

The language of section 9-507 reveals that the primary focus of commercial reasonableness is not the *proceeds* received from the sale but rather the *procedures* employed for the sale. If the secured creditor makes certain that conditions of the sale, in terms of the aggregate effect of the manner, method, time, place and terms employed conform to commercially accepted standards, he should be shielded from the sanctions contained in Article 9.

<sup>56</sup> See, e.g., *FDIC v. Forte*, 144 A.D.2d 627, 628, 535 N.Y.S.2d 75, 77 (2d Dep't 1988); *First Bank Trust Co. v. Mitchell*, 123 Misc. 2d 386, 395, 473 N.Y.S.2d 697, 703 (Sup. Ct. Tompkins County 1984); see also *FERRIS & GOLDSTEIN*, *supra* note 4, at 153 (noting that low price alone is not enough to show commercial unreasonableness, but discrepancies between sale price and market value invite closer scrutiny).

<sup>57</sup> "[T]here should be no undue delay between the time of repossession and the time of disposition, and ... any delay which does occur should be justifiable." *FERRIS & GOLDSTEIN*, *supra* note 4, at 191; see also *Forte*, 144 A.D.2d at 628, 535 N.Y.S.2d at 77 (inquiring further into sale which occurred over year after repossession). A justifiable delay would be one which maximizes the price recovered at the sale. *Fletcher v. Cobuzzi*, 499 F. Supp. 694, 700 (W.D. Pa. 1980). In addition, the fact that extensive planning and preparation are required to prepare the goods for sale can render the delay justifiable. *FERRIS & GOLDSTEIN*, *supra* note 4, at 192-93. In contrast, if the property would depreciate quickly, like a computer, it may be more important to sell the property quickly. *Id.* at 193.

<sup>58</sup> N.Y.U.C.C. § 9-507(2) (McKinney 1990); see, e.g., *First Nat'l Bank v. G.F. Clear, Inc.*, 93 A.D.2d 925, 926, 462 N.Y.S.2d 327, 329 (3d Dep't 1983) (holding that sale was commercially reasonable when conducted according to auctioneer's usual practices); *Forte*, 144 A.D.2d at 630, 535 N.Y.S.2d at 78 (Rubin, J., dissenting) (noting that sale is commercially reasonable if it has judicial approval). When the disposition is approved in a judicial proceeding, it is conclusively deemed to be commercially reasonable. N.Y.U.C.C. § 9-507(2) (McKinney 1990).

commercial reasonableness.<sup>59</sup>

*C. Secured Party's Noncompliance with Section 9-504(3)*

A secured party fails to comply with section 9-504(3) in two instances: (1) by failing to give reasonable notification<sup>60</sup> and (2) by failing to conduct a commercially reasonable sale.<sup>61</sup>

Section 9-507(1) is the only provision in Article 9 that addresses the secured party's failure to comply with the statutory requirements.<sup>62</sup> It simply provides that disposition may be "ordered or restrained[;]" if disposition has already occurred, the debtor has the right to recover from the secured party "any loss caused by" the noncompliance.<sup>63</sup> Courts place the burden of proving compliance upon the secured creditor.<sup>64</sup>

The split among courts regarding the effect of noncompliance upon the creditor's right to a deficiency judgment stems from the differing interpretations of the interplay between sections 9-504 and 9-507.<sup>65</sup> In addition to disagreeing with respect

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<sup>59</sup> See N.Y.U.C.C. § 9-507 Official Comment 2 at 578 (McKinney 1990).

<sup>60</sup> N.Y.U.C.C. § 9-504(3) (requiring reasonable notification); see *Chrysler Credit Corp. v. H & H Chrysler-Plymouth-Dodge, Inc.*, 927 F.2d 270, 274 (6th Cir. 1991) (concluding that creditor's failure to give "reasonable notification" of sale rendered sale commercially unreasonable).

<sup>61</sup> See N.Y.U.C.C. § 9-504(3) (requiring all aspects of dispositions to be commercially reasonable); see, e.g., *Forté*, 144 A.D.2d at 629, 535 N.Y.S.2d at 77 (concluding circumstances surrounding sale were commercially reasonable because of time lapse between foreclosure and sale, as well as price discrepancy).

<sup>62</sup> N.Y.U.C.C. § 9-507(1) (McKinney 1990); see *In re Replogle*, 10 U.C.C. Rep. Serv. 2d (Callaghan) 1048, 1052 (Bankr. D. Mass. 1989) ("The U.C.C., however, contains no provision dealing with the effect of a commercially unreasonable disposition upon the secured party's right to recover a deficiency."), *rev'd on other grounds*, 929 F.2d 836 (1st Cir. 1991); *Associates Fin. Servs. Co., Inc. v. DiMarco*, 383 A.2d 296, 302 (Del. 1978) (noting that New York Code draftsmen did not directly face question of nonconforming sale and noting split in jurisdiction as to allowance of deficiency judgment); see also 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, § 44.9.10 at 1253 (1965) (suggesting omission was an oversight and that secured creditor's misconduct has no effect on deficiency claim).

<sup>63</sup> N.Y.U.C.C. § 9-507(1) (McKinney 1990).

<sup>64</sup> See *In re Excello Press, Inc.*, 890 F.2d 896, 901 (7th Cir. 1989) ("New York courts ... say that compliance with § 9-504(3) is part of the creditor's proof in a deficiency action.").

<sup>65</sup> Many courts hold that noncompliance on the part of the creditor creates a bar to a deficiency judgment. See *infra* notes 70-82 and accompanying text (discussing absolute bar rule). Others apply § 9-507(1) as the sole remedy available to the debtor. See *infra* notes 83-94 and accompanying text (discussing setoff rule). Still other courts construct a "rebuttable presumption" as to the value of the collateral when faced with creditor noncompliance. See *infra* 95-107 and accompanying text (discussing rebuttable presumption rule).

to the interaction of the applicable New York Code sections, some courts also apply different rules depending on whether noncompliance stems from lack of notice or a commercially unreasonable sale.<sup>66</sup> This distinction seems counterintuitive; lack of reasonable notification should result in a finding that the secured creditor did not act in a commercially reasonable manner.<sup>67</sup> By collapsing reasonable notification into "commercial reasonableness," courts may find compliance with section 9-504(3), despite the lack of notice, if the overall circumstances surrounding the sale were commercially reasonable.<sup>68</sup> Rather than making

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<sup>66</sup> See, e.g., *City Nat'l Bank v. Unique Structures, Inc.*, 49 F.3d 1330, 1333 n.3 (8th Cir. 1995) (noting that Arkansas applied absolute bar rule in lack of notice cases and rebuttable presumption rule in commercially unreasonable sale cases); *In re Excello Press, Inc.*, 890 F.2d 896, 904 (7th Cir. 1989) (concluding that New York would use "middle-of-the-road" position between absolute bar and no effect on creditor's claim); *Roc-Century Assoc. v. Giunta*, 658 A.2d 223, 226 (Me. 1995) (applying absolute bar rule when faced with lack of notice and rebuttable presumption rule when faced with commercially unreasonable sale); *Ruden v. Citizens Bank & Trust Co.*, 638 A.2d 1225, 1234 (Md. Ct. Spec. App. 1994) (noting trend in some courts to make distinction between no-notice cases and other commercially unreasonable behavior), *cert. denied*, 677 A.2d 445 (1994). *But cf.* *Wanda M. Temm, Creditor Beware: From Default Through Deficiency Judgment*, 60 J. KAN. B.A. 17 (Oct. 1991) (noting that Kansas utilizes absolute bar rule for creditor misbehavior in consumer transactions and rebuttable presumption rule in commercial transactions).

<sup>67</sup> See *Topeka Datsun Motor Co. v. Stratton*, 736 P.2d 82, 86 (Kan. Ct. App. 1987) (stating that "[c]ommercial reasonableness is an umbrella term which encompasses all aspects of the sale including the notice given ...."); *United States v. Willis*, 593 F.2d 247, 256 (6th Cir. 1979). The court stated in *Willis*:

This distinction is without legal significance. The crucial question under consideration concerns "commercial reasonableness"; this remains so whether the factual context in which the issue is presented focuses upon proper notification prior to sale or the manner in which the sale is actually consummated .... this requirement must be satisfied whether the facts involve a commercially reasonable notice prior to sale, or the commercial reasonableness of the sale itself.

*Id.*; see also *Hoch v. Ellis*, 627 P.2d 1060, 1062 (Alaska 1981) (noting that rebuttable presumption rule applies to cases in which sale was deficient in respect to either notification or commercial reasonableness of sale); *Associates Capital Servs. Corp. v. Riccardi*, 408 A.2d 930, 932 (R.I. 1979) (rejecting absolute bar to deficiency judgments as against Uniform Code's policy of fairness). See generally David Lance Swanson, Note, *The Disposition of Repossessed Collateral in Tennessee: Notice, Commercial Reasonableness, and Deficiency Judgments*, 16 MEM. ST. U. L. REV. 375, 389-94 (1986) (discussing factors, including notice, that affect commercial reasonableness standard). *But see id.* at 377 n.10-11 and accompanying text (indicating that at least one commentator believes commercial reasonableness and notification are distinct and exclusive concepts) (citing Douglas M. Mancino, Note, *Denial of Deficiency: A Problem of Reasonable Notice Under UCC § 9-504(3)*, 34 OHIO ST. L.J. 657, 666 (1973)).

<sup>68</sup> See Swanson, *supra* note 67, at 379 (stating that interrelatedness of notice and



the rules unduly complex and requiring different tests for different situations, the distinction should simply be reflected in the amount of damages the debtor is entitled to under section 9-507(1). For example, if the debtor can prove that it was able to redeem the collateral had notice been given, a debtor's damages should be increased accordingly.<sup>69</sup>

## II. APPROACHES TAKEN BY NEW YORK COURTS

### A. Absolute Bar

The Second Department regards the secured party's compliance with section 9-504(3) as a condition precedent to the secured creditor's ability to obtain a deficiency judgment.<sup>70</sup> Many

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commercial reasonableness permits "judicial discretion to find a given sale commercially reasonable even in the absence of compliance with the notice provision". This reasoning can also work in the reverse, allowing a court to consider an otherwise reasonable sale to be unreasonable due to the lack of notice. *See* *Woodward v. Resource Bank*, 436 S.E.2d 613, 617 (Va. 1993) (holding that secured party did not meet burden of proving compliance with statute because failure to give notice made sale commercially unreasonable); *see also In re Excella Press, Inc.*, 890 F.2d 896, 905 (7th Cir. 1989) ("Failure to give notice is evidence of commercially unreasonable behavior.").

<sup>69</sup> *But see* *Holt v. Peoples Bank*, 814 S.W.2d 568, 571 (Ky. 1991) (asserting that without notice debtor cannot redeem). The *Holt* court felt that such behavior on the part of a secured party is so egregious as to justify an absolute bar to the creditor recovering a deficiency judgment.

<sup>70</sup> *See supra* notes 31-35 and accompanying text (discussing pre-Code law under U.C.S.A.). Courts adopting this approach consider the interpretation of the U.C.S.A. as not being displaced by the New York Code provisions. Thus, as in pre-Code law, the noncomplying creditor forfeits his right to a deficiency judgment. *Leasco Data Processing Equip. Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 1091, 323 N.Y.S.2d 13, 15 (N.Y. Civil Ct. N.Y. County 1971); *e.g.*, *Central Budget Corp. v. Garrett*, 48 A.D.2d 825, 826, 368 N.Y.S.2d 268, 270 (2d Dep't 1975); *Long Island Bank v. Knight*, 122 Misc. 2d 878, 878, 473 N.Y.S.2d 901, 902 (Sup. Ct. App. Term 2d Dep't 1983); *Avis-Rent-A-Car Sys., Inc. v. Franklin*, 82 Misc. 2d 66, 67, 366 N.Y.S.2d 83, 85 (Sup. Ct. App. Term 2d Dep't 1975); *Chandler Leasing Corp. v. Durante Bros. & Sons, Inc.*, 24 U.C.C. Rep. Serv. (Callaghan) 804, 807 (Sup. Ct. Queens County 1978); *accord* *Security Pacific Nat'l Bank v. Kirkland*, 915 F.2d 1236, 1242 (9th Cir. 1990); *Peoples Bank v. Roberts*, 779 F.2d 1544, 1546 (11th Cir. 1986); *Nixdorf Computer, Inc. v. Jet Forwarding, Inc.*, 579 F.2d 1175, 1179 (9th Cir. 1978); *Atlas Thrift Co. v. Horan*, 104 Cal. Rptr. 315, 321 (Cal. Ct. App. 1972) (citing *Leasco Data* case with approval); *Chittenden Trust Co. v. Andre Noel Sports*, 621 A.2d 215, 220 (Vt. 1992); *see also* Elizabeth Dalton, Note, *The Consequences of Commercially Unreasonable Dispositions of Collateral: Haggis Management, Inc. v. Turtle Management, Inc.*, 1986 UTAH L. REV. 813, 816 (recognizing that one of four rationales posited to support application of absolute bar rule is reliance upon pre-Code decisions). *But see* Norma G. Formanek, Comment, *The California Article 9 No-Deficiency Rule: Undermining the Secured Party's Security*, 34 HASTINGS L.J. 153, 163-68 (1982)

states in which the Uniform Conditional Sales Act preceded the Uniform Commercial Code adopted this principle.<sup>71</sup> The aim of this approach is to deter noncompliance by the secured creditor.<sup>72</sup>

(criticizing California Appellate Court's reliance in *Atlas Thrift* upon pre-U.C.C. common law because § 1-103 does not authorize resort to pre-U.C.C. law).

The New York Appellate Division, Second Department, adopted this approach in *Leasco Data Processing Equipment, Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 1093, 323 N.Y.S.2d 13, 19 (N.Y. Civ. Ct. N.Y. County 1971), holding that the secured party forfeited the right to a deficiency judgment because of the failure to comply with the statute by notifying the debtor of the time of the sale. *Leasco Data* involved a leasing agreement between the plaintiff corporation and defendant company for certain equipment. *Id.* at 1089, 323 N.Y.S.2d at 14. The debtor's default caused acceleration of the remaining balance and lawful repossession of the equipment. *Id.* Upon subsequent disposition of the collateral, the fair market value of the property was received but the creditor failed to notify the debtor of the time of the sale as required by § 9-504(3). *Id.* at 1090, 323 N.Y.S.2d at 14. The secured party sought a deficiency judgment for the amount of the debt not realized by the proceeds from the sale. *Id.*

The court relied on three reasons for adopting the absolute bar rule. First, the court noted that the drafters of the New York Code did not expressly manifest an intention to change pre-Code law, the Uniform Conditional Sales Act. *Id.* at 1090, 323 N.Y.S.2d at 15 ("If the authors of the Uniform Commercial Code proposed to overthrow the firmly established and generally accepted construction of the older statute ... they surely would have manifested that intent in clear and unambiguous language."). Second, turning to a textual analysis of New York Code § 9-504, the court reasoned that since the section contained both the commercial reasonableness and notice requirements without stating they were independent of each other, the provisions must be read as interrelated. *Id.* at 1091, 323 N.Y.S.2d at 16. Third, the court asserted that § 9-507(1) was not a defense to a deficiency judgment action; rather, it is an affirmative action enabling the debtor to recover damages caused by the secured party's noncompliance. *Id.* at 1092, 323 N.Y.S.2d at 16. The court stated:

If [9-507] were intended to authorize a defense to an action for a deficiency judgment, it is hard to envisage language less apt to that purpose. The words used plainly contemplate an affirmative action to recover for a loss that has already been sustained — not a defense to an action for a deficiency.

*Id.* The court's final words epitomize the thrust of the absolute bar approach: "The burden on the secured creditor is by no means onerous. If he wishes a deficiency judgment he must obey the law .... If he does not obey the law he may not secure a deficiency judgment." *Id.* at 1093, 323 N.Y.S.2d at 17.

<sup>71</sup> See, e.g., *Wells Fargo Bank v. Carter*, 511 F.2d 1203, 1205 (9th Cir. 1975); *Atlas Thrift Co.*, 104 Cal. Rptr. at 318 (citing pre-Code California law); *Wilmington Trust Co. v. Conner*, 415 A.2d 773, 777 (Del. 1980) (noting that under U.C.S.A., strict compliance with notice requirement was condition precedent to collecting deficiency judgment); *C.I.T. Corp. v. Haynes*, 212 A.2d 436, 439 (Me. 1965); *Frantz Equip. Co. v. Anderson*, 181 A.2d 499, 505 (N.J. 1962).

<sup>72</sup> See Terry M. Anderson, *Noncomplying Secured Creditors, Deficiency Judgments, and Implied Satisfaction Under the Nebraska Uniform Commercial Code*, 26 CREIGHTON L. REV. 1, 15 (1992). "If the primary [goal] ... is to compel secured creditor compliance ... , then obviously the absolute bar rule works best. If the consequence of every breach is denial of a deficiency, then creditors will be careful in-

what better way to encourage creditors to follow the mandate of the statute than to threaten their right to recover monies not received in the disposition of the collateral? Courts and commentators have proffered various reasons supporting the absolute bar approach.<sup>73</sup> One commentator noted that in light of the "minimum formal requirements"<sup>74</sup> that now are contained in the New York Code, the conclusion to bar absolutely a deficiency judgment is more reasonable than under pre-Code law.<sup>75</sup> An-

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deed." *Id.*

<sup>73</sup> For example, in *Credit Car Leasing Corp. v. DeCresenzo*, 138 Misc. 2d 726, 733, 525 N.Y.S.2d 492, 497 (N.Y. Civ. Ct. N.Y. County 1988), the New York Civil Court noted that the absolute bar rule was sound because "[t]he burden on the creditor to comply with the notice provision is minimal in light of the benefit to the debtor's ability to protect his or her interest in the collateral." See Formanek, *supra* note 70, at 159 (stating that "secured party should not be allowed to recover a benefit from his or her wrong"); William B. Davenport, *Default, Enforcement and Remedies Under Revised Article 9 of the Uniform Commercial Code*, 7 VAL. U. L. REV. 265, 300 (1978) (describing no-deficiency rule as "judicially created penalty"). At least one commentator has stated that secured parties consistently do not attempt to maximize the price received at the sale to benefit both the debtor and creditor. See Philip Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 STAN. L. REV. 20, 26-28 (1969). Professor Shuchman discusses several cases in which the secured creditors' repossession and resale of cars for almost less than half value caused the courts to conclude that the absolute bar rule was the correct approach. *Id.* But see *In re Excella Press, Inc.*, 890 F.2d 896, 901 (7th Cir. 1989). The Seventh Circuit noted that secured parties have no reason not to maximize the price received at resale. *Id.* The court reasoned that a secured party would want to take advantage of receiving the dollar today rather than having to enforce a deficiency tomorrow. *Id.*

<sup>74</sup> The Vermont Supreme Court in *Chittenden Trust Co.*, 621 A.2d at 215, 218-19, noted that it is not unreasonable to require compliance with the notice requirement by the secured party because it is one of the few requirements of its kind in the Uniform Code. But see *Woodward v. Resource Bank*, 436 S.E.2d 613, 617 (Va. 1993) (refusing to adopt absolute bar rule because it was "unduly harsh and punitive"); Edward J. Heiser, Jr. & Robert J. Flemma, Jr., *Consumer Issues in the Article 9 Revision Project: The Perspective of Consumer Lenders*, 48 CONSUMER FIN. L.Q. REP. 488, 491-92 (1994) (articulating that consumer creditor group opposes anti-deficiency rule because it is "punitive ... [with] no place in the UCC," provides debtors with incentives to abuse law by "look[ing] for technical violations ... [which have no] adverse impact on the debtor," and that it relegates secured creditor to worse position than unsecured creditor contrary to UCC purpose).

<sup>75</sup> See 2 GRANT GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* 1264, § 44.9.4 (1965). In choosing the absolute bar approach as the most reasonable, Gilmore referred to Judge Willson's opinion in *Skeels v. Universal C.I.T. Credit Corp.*, 222 F. Supp. 696 (W.D. Pa. 1963), *vacated on other grounds*, 335 F.2d 846 (3d Cir. 1964). In *Skeels*, the secured party failed to give the debtor notice of the sale of his collateral. *Id.* at 696. The court held that allowing "recovery by the security holder of a loss in disposing of collateral when no notice has been given, permits a continuation of the evil which the Commercial Code sought to correct.... It was the secret disposition of collateral by chattel mortgage owners and others which was [the]

other rationale for the approach uses section 1-103 of the New York Code, which provides that unless otherwise displaced by the particular section of the New York Code, pre-Code law shall supplement the New York Code provisions.<sup>76</sup>

There are several defects in the reasoning employed by courts following the absolute bar rule. First, section 9-101 of the New York Code notes the intention of the drafters to replace the common law.<sup>77</sup> Second, both the New York Code and the Uniform Code policies discourage punitive damages.<sup>78</sup> Moreover, the

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evil ...” *Id.* at 702.

It is worth noting that most of the courts which impose the absolute bar rule upon misbehaving creditors are faced with cases involving lack of notice. As the Supreme Court of Kentucky stated, “[t]he greatest protection available to debtors from unscrupulous conduct by secured parties who have repossessed collateral is notice of disposition of the collateral.” *Holt v. Peoples Bank*, 814 S.W.2d 568, 571 (Ky. 1991). Often, when faced with a commercially unreasonable sale, the same court which when confronted with lack of notice applied the absolute bar rule, will now apply the rebuttable presumption rule. *Compare* *One Twenty Credit Union v. Darcy*, 5 U.C.C. Rep. Serv. (Callaghan) 792 (1968) (lack of notice barred deficiency judgment) *with* *First Agricultural Bank v. Replogle*, 10 U.C.C. Rep. Serv. 2d (Callaghan) 1048 (1989) (applying rebuttable presumption rule due to commercially unreasonable sale). It is submitted that this is a result that derives from the misconception that notice and commercial reasonableness are two separate and distinct concepts. It is further submitted that courts should apply the same test regardless of which portion of the statute is violated.

<sup>76</sup> N.Y.U.C.C. § 1-103 (McKinney 1990) provides that:

[U]nless displaced by the particular provisions of this act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

*Id.*; see *Atlas Thrift Co. v. Horan*, 104 Cal. Rptr. 315, 320-21 (Cal. Ct. App. 1972) (allowing pre-Code California law to supplement Code sections pertaining to default, thus barring noncomplying creditor from obtaining deficiency judgment); *Wilmington Trust Co. v. Conner*, 415 A.2d 773, 779 (Del. 1980) (applying pre-Code Delaware law to deny deficiency judgment); *Chittenden Trust Co. v. Andre Noel Sports*, 621 A.2d 215, 220 (Vt. 1992) (citing § 1-103 as reason for applying absolute bar rule).

<sup>77</sup> N.Y.U.C.C. § 9-101 Official Comment at 290 (McKinney 1990). This section notes that “[the Code] supersedes prior legislation dealing with ... conditional sales ....” In addition, Official Comment 2 to § 9-504 explicitly notes that subsection (1) was intended to follow prior law. N.Y.U.C.C. § 9-504 Official Comment 2, at 554 (McKinney 1990). It is reasonable to assume that the drafters would have explicitly indicated their intention to interpret subsections (2) and (3) consonant with prior law. Thus, the argument furthered by the court in *Leasco Data*, that the New York Code did not change the common law in New York, is without merit. See *supra* note 70 (discussing rationale of *Leasco Data* court).

<sup>78</sup> See N.Y.U.C.C. § 1-106 (McKinney 1990) (“[N]either consequential or special nor penal damages may be had except as specifically provided in this Act ... .”) (emphasis added). Even courts which adopt the absolute bar rule must concede that the absolute bar rule is not specifically provided for in the Code and that employing

blanket imposition of an absolute bar upon a secured creditor could have very harsh consequences in certain circumstances.<sup>79</sup> For example, two different creditors, one owed a deficiency of one million dollars and the other a deficiency of one hundred dollars, could each make the same error, yet one would be penalized more harshly than the other.<sup>80</sup> Advocates of the absolute bar approach seem to give little thought to the rights of the secured party.<sup>81</sup> One court eloquently stated: "[T]he spirit of commercial reasonableness requires that the secured party not be arbitrarily deprived of his deficiency...."<sup>82</sup> Since the absolute bar rule often arbitrarily deprives creditors of the deficiency, it clearly does not comport with the policies of the New York and Uniform Codes and should not be followed.

### B. Setoff Rule

The New York Appellate Division, Third Department, is among the minority of courts that employ the "setoff rule."<sup>83</sup> This rule rejects the automatic denial of a deficiency judgment and instead limits the debtor's remedies to those granted in section

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such a rule is akin to imposing punitive damages upon the secured creditor. *See Bank of Chapmanville v. Workman*, 406 S.E.2d 58, 64 (W. Va. 1991) (calling absolute bar rule "judge-made punitive provision"). An additional argument against the absolute bar rule is that it "involves a forfeiture, and the law generally disfavors forfeitures." *Id.* at 64.

<sup>79</sup> *See id.*

<sup>80</sup> *Id.*

<sup>81</sup> *See Formanek, supra* note 70, at 174. The author asserts that in a typical secured transaction, the secured creditor assumes the risk that the debtor will default. *Id.* The security interest is supposed to protect the debtor from such a risk, but often the collateral has declined in value. *Id.* The purpose of the deficiency judgment is to compensate the secured party for the decreased value of the property which secures the debt. *Id.*

<sup>82</sup> *Conti Causeway Ford v. Jarossy*, 276 A.2d 402, 404 (N.J. Super. 1971), *aff'd*, 288 A.2d 872 (N.J. Super. Ct. App. Div. 1972); *see Midatlantic Nat'l Bank v. Coyne*, 537 A.2d 798, 803 (N.J. Super. Ct. Law Div. 1987) (stating that appropriate manner to deal with problem is "doing justice to both parties"); *see also Security Sav. Bank v. Tranchitella*, 592 A.2d 284, 290 (N.J. Super. Ct. App. Div. 1991) (stating that "[t]here is no reason why a debtor should receive a windfall" because it is "appropriate [to] recogni[ze] ... the legitimate interests of both parties") (emphasis added).

<sup>83</sup> *See, e.g., Stanchi v. Kemp*, 48 A.D.2d 973, 974, 370 N.Y.S.2d 26, 28 (3d Dep't 1975) (noting that failure of secured creditor to comply with § 9-504 would not discharge debtor from all liability under contract); *Lincoln Rochester Trust Co. v. Howard*, 75 Misc. 2d 181, 182, 347 N.Y.S.2d 306, 308 (Rochester City Ct. 1973) (holding that § 9-507(1) establishes penalties for noncompliance); *see also Formanek, supra* note 70, at 160 (describing setoff rule).

9-507(1).<sup>84</sup> Under section 9-507(1), the debtor is required to affirmatively prove that he was injured by a creditor's lack of notice or commercially unreasonable behavior.<sup>85</sup> Thus, the secured party is always entitled to a deficiency judgment reduced by the amount of damages the debtor is able to prove.<sup>86</sup> The policy behind this approach is to compensate the debtor for the damages caused by the creditor's misbehavior.<sup>87</sup> Section 9-507(1) allows the court to "reach the merits" of each case, and thus to equitably measure the damages to the debtor in terms of the harm caused by the noncompliance.<sup>88</sup>

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<sup>84</sup> See 9A RONALD A. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE 643-46 (3d ed. 1994 & Supp. 1995) (explaining setoff approach including situations where such approach could apply); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 1252 (3d ed. 1988 & Supp. 1993) (examining case law support for setoff approach as well as consequences of using this approach in deciding deficiency judgments); Formanek, *supra* note 70, at 160 ("[T]he debtor's remedies are limited to those provided in section 9-507(1): an affirmative suit against the secured party for damages, or setoff or counterclaim in the secured party's suit for a deficiency judgment."); Page, *supra* note 11, at 535 (noting that damages are limited under setoff approach to those set forth in § 9-507(1)).

<sup>85</sup> N.Y.U.C.C. § 9-507(1) (McKinney 1990) provides:

If it is established that the secured party is not proceeding in accordance with the provisions of this Part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus ten per cent of the cash price.

*Id.*

<sup>86</sup> In *Leasco Computer, Inc. v. Sheridan Indus.*, 82 Misc. 2d 897, 900, 371 N.Y.S.2d 531, 534 (N.Y. Civ. Ct. N.Y. County 1975), the New York Civil Court directly contradicted Judge Sandler's decision in *Leasco Data Processing Equip. Corp. v. Atlas Shirt Co.*, 66 Misc. 2d 1089, 323 N.Y.S.2d 13 (N.Y. Civ. Ct. N.Y. County 1975). The *Leasco Computer* court held that the debtor's exclusive remedy for noncompliance by a secured creditor is found in § 9-507(1). *Leasco Computer*, 82 Misc. 2d at 899-900, 371 N.Y.S.2d at 533-34; see *Chase Manhattan Bank v. Lyon Air, Inc.*, 8 U.C.C. Rep. Serv. (Callaghan) 1121 (Sup. Ct. N.Y. County 1971) (holding that § 9-507 does not absolve debtor of all liability when creditor fails to comply with § 9-504). Rejecting Judge Sandler's contention in *Leasco Data* that the New York Code did not change the law as it was under the U.C.S.A., Judge Okin emphasized the elimination of the detailed requirements of the former law. *Leasco Computer*, 82 Misc. 2d at 900, 371 N.Y.S.2d at 534. Accordingly, the court asserted that it was the burden of the buyer (or debtor) to show the loss caused by a failure to comply with the statute. *Id.*

<sup>87</sup> See Dalton, *supra* note 70, at 819 ("The aim of this approach is to compensate the debtor for actual damages suffered because of creditor noncompliance.").

<sup>88</sup> See Formanek, *supra* note 70, at 160 (noting that setoff approach allows courts

The reasoning most often asserted in support of the setoff approach is that it is expressly provided for in the New York Code, indicating that a complete bar was not intended and that section 9-507 is the exclusive remedy.<sup>89</sup> Because the New York Code is otherwise silent as to the ramifications of creditor non-compliance, advocates argue that section 9-507 must have been intended to occupy the field.<sup>90</sup> The problem inherent in this approach is that it places the burden of proving damages upon the debtor, often the party least able to prove such damages.<sup>91</sup> In many situations, if the debtor has not received notice of the sale, it is very difficult to prove that the fair market value of the property was greater than the amount received from the repossession sale.<sup>92</sup> In some situations, the debtor may not be damaged at all.<sup>93</sup> In addition, this approach may encourage noncompliance

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to measure damages caused by noncompliance because courts will "reach the merits" of every case; Page, *supra* note 11, at 539 (explaining how § 9-507 explicitly provides that damages be available to debtor based upon creditor's noncompliance).

<sup>89</sup> See *Barbour v. United States*, 562 F.2d 19, 21 (10th Cir. 1977) (limiting debtor's recovery to that expressly provided for in § 9-507(1)); see also *Dalton*, *supra* note 70, at 819 (noting that since Code does not deny deficiency judgments under § 9-504(3), under setoff approach § 9-507(1) serves as debtor's only remedy); Formanek, *supra* note 70, at 166-67. Advocates of this approach assert that by incorporating the section caption ("Secured Party's Liability for Failure to Comply with this Part") into the substantive content of § 9-507, it is clear that the section was intended to provide a comprehensive listing of the debtor's remedies in the event of the secured party's noncompliance. *Id.*

<sup>90</sup> See Formanek, *supra* note 70, at 159-60 (reporting on group of courts that limit debtor's remedies to those provided in § 9-507(1)). But see *Leasco Data Processing Equip. Corp. v. Atlas Shirt Co., Inc.*, 66 Misc. 2d 1089, 1092, 323 N.Y.S.2d 13, 16 (N.Y. Civ. Ct. N.Y. County 1971) (asserting that § 9-507 contemplates only affirmative actions to recover losses sustained due to creditor noncompliance).

<sup>91</sup> See Robert M. Lloyd, *The Absolute Bar Rule in UCC Foreclosure Sale: A Prescription for Waste*, 40 U.C.L.A. L. REV. 695, 723 (1993) (stating that problems with setoff rule are "so widely recognized that courts seldom apply the ... rule anymore").

<sup>92</sup> See *Bank of Chapmanville v. Workman*, 406 S.E.2d 58, 65 (W. Va. 1991). The *Chapmanville* court drew the following analogy:

[T]he debtor may be in a position similar to that of a surgery patient who has difficulty knowing what went wrong in the operating room, either because he does not understand what was being done to him on the operating table, or because he lay unconscious under a general anesthetic during the surgery. Like the surgery patient, the debtor may have trouble determining, much less proving, what went wrong at a commercially unreasonable sale. This is especially true for the debtor who is not present at the sale, for he is like the surgery patient who is unconscious during the operation.

*Id.*; see also Lloyd, *supra* note 91, at 723 (maintaining that facts necessary to prove damages are "much more readily available to the secured party than they are to the debtor").

<sup>93</sup> For example, suppose that the debtor owes the secured party \$10,000 upon de-

on the part of the secured party because if the creditor can foresee the debtor incurring minimal or no damages, the creditor can make a business judgment and decide to conduct the sale in the manner of his choosing, absorbing the debtor's minimal damages as an expense of doing business.<sup>94</sup> This result would clearly contravene the New York Code's objective of protecting debtors from dishonest creditors.

### *C. Rebuttable Presumption Rule*

Dissatisfied with the results of both the absolute bar and setoff rules, the First and Fourth Departments have adopted the rebuttable presumption approach.<sup>95</sup> Under this rule, the secured party is not prohibited from recovering a deficiency judgment.<sup>96</sup>

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fault and at repossession the collateral has a fair market value of \$8,000. Suppose further that the secured party resells the collateral, without notice to the debtor, and receives \$8,000. In this hypothetical, the debtor can recover no damages under § 9-507(1) because the debtor is not actually damaged. Formanek, *supra* note 70, at 173-74.

<sup>94</sup> Indeed, § 9-507(1) is designed to protect other creditors as well as the debtor. The Official Comment states "it is vital both to the debtor and other creditors to provide a remedy for the failure [of the secured creditor] to comply with the statutory duty." N.Y.U.C.C. § 9-507 Official Comment 1, at 577 (McKinney 1990).

<sup>95</sup> See, e.g., *Telmark, Inc. v. Lavigne*, 124 A.D.2d 1055, 1055, 508 N.Y.S.2d 737, 738 (4th Dep't 1986) (applying rebuttable presumption rule in granting partial summary judgment to secured creditor); *General Elec. Credit Corp. v. Durante Bros. & Sons*, 79 A.D.2d 509, 510-11, 433 N.Y.S.2d 574, 577 (1st Dep't 1980) (granting creditor deficiency judgment on basis of rebuttable presumption rule); *S.M. Flickinger Co. v. 18 Genesee Corp.*, 71 A.D.2d 382, 385, 423 N.Y.S.2d 73, 76 (4th Dep't 1979) (noting that rebuttable presumption rule applies and therefore creditor may receive deficiency judgment); *Security Trust Co. v. Thomas*, 59 A.D.2d 242, 246-47, 399 N.Y.S.2d 511, 513 (4th Dep't 1977) (adopting rebuttable presumption rule as applicable under New York law). The rebuttable presumption rule is sometimes referred to as the "Arkansas Rule" in recognition of the first case to adopt this approach, *Norton v. National Bank of Commerce*, 398 S.W.2d 538 (Ark. 1966). The *Norton* court asserted that by failing to give notice the secured party makes it difficult for the debtor to prove the extent of his loss and that "the just solution is to indulge the presumption in the first instance that the collateral was worth at least the amount of the debt, thereby shifting to the creditor the burden of proving the amount that should reasonably have been obtained through a sale conducted according to law." *Id.* at 542; see also *Universal C.I.T. Credit Co. v. Rone*, 453 S.W.2d 37, 41 (Ark. 1970) (adopting rebuttable presumption rule).

<sup>96</sup> See, e.g., *Chrysler Credit Corp. v. Mitchell*, 94 A.D.2d 971, 971, 464 N.Y.S.2d 96, 97 (4th Dep't 1983) (holding that failure to comply does not preclude secured creditor from receiving deficiency judgment); *S.M. Flickinger Co.*, 71 A.D.2d at 385, 423 N.Y.S.2d at 76 (holding that under rebuttable presumption rule noncompliance does not deprive plaintiff/creditor of deficiency judgment); see also *Paco Corp. v. Vigliarola*, 611 F. Supp. 923, 925 (E.D.N.Y. 1985); ANDERSON, *supra* note 84, at 640-43 (discussing rebuttable presumption rule).



If the debtor alleges noncompliance with section 9-504(3), a rebuttable presumption arises, in favor of the debtor, that the repossessed collateral had a fair market value equal to the outstanding debt.<sup>97</sup> In order to rebut this presumption, the secured party must come forward with evidence suggesting "the reasonable amount the collateral would get at a proper sale."<sup>98</sup> Unless the secured party rebuts this presumption, the debtor owes no deficiency.<sup>99</sup> Under this approach, despite acting in a commercially unreasonable manner, if the secured party can prove that the fair market value of the collateral was less than the outstanding debt, the court will issue a deficiency judgment.<sup>100</sup>

Advocates of this approach assert that "the spirit of commercial reasonableness" pervasive throughout the New York Code supports the application of the rebuttable presumption

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<sup>97</sup> See, e.g., *Security Trust Co.* at 247, 399 N.Y.S.2d at 514 (holding that noncomplying creditors may still recover deficiency judgment by proving: amount of debt, fair market value of collateral and resulting deficiency); see *Dalton*, *supra* note 70, at 820 (explaining rebuttable presumption rule and its general application); *Page*, *supra* note 11, at 535-36 (reporting on rebuttable presumption or "shift" approach and requirements for proving creditor's deficiency under said rule).

<sup>98</sup> *Associates Capital Servs. Corp. v. Riccardi*, 408 A.2d 930, 934 (R.I. 1979); see also *In re Excello Press, Inc.*, 890 F.2d 896, 904-05 (7th Cir. 1989) (citing importance of evidence of fair market value in evaluating commercially reasonable sale); *Dischner v. United Bank Alaska*, 631 P.2d 107, 110 (Alaska 1981) (requiring showing of clear and convincing evidence of fair and reasonable value of collateral in order to rebut presumption).

In *Kobuk Eng'g & Contracting Servs., Inc. v. Superior Tank & Constr. Co. Alaska*, 568 P.2d 1007, 1013-14 (Alaska 1977), the Supreme Court of Alaska noted two ways in which the presumption may be rebutted: "(1) obtaining a fair and reasonable appraisal at or near the time of repossession, or (2) producing convincing evidence of the value of the collateral." *Id.* To meet this last requirement, the creditor must prove both the condition of the collateral and the usual price collateral in a similar of such condition would bring. *Id.* at 1014. This burden can be accomplished through both testimonial and documentary evidence. See *Dalton*, *supra* note 70, at 821. The sale price can only be used to prove the value if the sale was commercially reasonable; otherwise, some other proof of fair market value must be proffered. *Id.* See generally *Page*, *supra* note 11, at 548-51 (discussing price, stipulations, appraisals, market conditions, and subsequent sales as types of evidence used to establish value).

<sup>99</sup> See *Dalton*, *supra* note 70, at 820 ("Unless the presumption is rebutted, the secured party may not recover a deficiency.").

<sup>100</sup> In this situation, the fair market value of the collateral at the time of the sale, not the actual proceeds from the sale, will be subtracted from the debt in order to ascertain the amount of the deficiency. See *Cornett v. White Motor Corp.*, 209 N.W.2d 341, 344 (Neb. 1973).

rule.<sup>101</sup> The facts concerning the sale of the collateral are usually within the creditor's knowledge.<sup>102</sup> This is especially true where the debtor received no notice of the sale, was not present at the sale, and thus would have great difficulty proving the extent of his loss. It is also argued that it is more appropriate to place the burden of proof upon the party who failed to comply with the statute.<sup>103</sup>

The fault inherent in this rule is its failure to recognize the debtor's remedies provided in section 9-507(1). Courts that adopt this approach imply that the secured party is punished and the debtor is compensated by the creation of the presumption that the fair market value of the property is equal to the debt.<sup>104</sup> In situations where the creditor's noncompliance was due to a failure to conduct the sale in a commercially reasonable manner, this may be true. In those situations, the debtor is injured because the collateral was not sold at its fair market value and the

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<sup>101</sup> See *General Elec. Credit Corp.*, 79 A.D.2d at 511, 433 N.Y.S.2d at 577 (holding that "spirit of commercial reasonableness" leads to acceptance of rebuttable presumption rule); see also *United States v. Willis*, 593 F.2d 247, 260 (6th Cir. 1979) (calling rebuttable presumption rule "more enlightened and equitable" than absolute bar rule); *Ruden v. Citizens Bank & Trust Co.*, 638 A.2d 1225, 1239 (Md. Ct. Spec. App. 1994) (noting that rule represents "a fair accommodation between the legitimate interests of the debtor and the [creditor]"), *cert. denied*, 647 A.2d 445 (Md. 1994); see also Page, *supra* note 11, at 536-47 (discussing trend of courts emphasizing policy of commercial reasonableness).

<sup>102</sup> See *Woodward v. Resource Bank*, 436 S.E.2d 613 (Va. 1993). In *Woodward*, the court focused on the fact that the secured party acquired possession of the collateral and conducted the sale. *Id.* at 617. In light of this fact, the court concluded that "the secured party is in the best position to present evidence of the fair market value of the collateral." *Id.*

<sup>103</sup> See *In re Winer*, 39 B.R. 504, 511 (Bankr. S.D.N.Y. 1984) (concluding "the proper and equitable construction of the Uniform Commercial Code ... is in accordance with this middle ground position"); *Shawmut Bank v. Chase*, 609 N.E.2d 479, 483 (Mass. App. Ct. 1993) (stating that placing burden of proof on party failing to follow statute is more likely to encourage future compliance). In *Bank of Chapmanville v. Workman*, 406 S.E.2d 58, 65 (W. Va. 1991), the court continued its analogy of the debtor and the surgery patient, see *supra* note 92, and analogized the availability of *res ipsa loquitur* for rescuing the surgery patient to the rebuttable presumption rule which rescues the debtor. *Id.* Since a debtor who was not present at the sale is similar to an unconscious patient, it seems only fair to create a presumption where the misbehaving party is required to rebut the evidence before recovering its deficiency. *Id.*

<sup>104</sup> *Shawmut Bank*, 609 N.E.2d at 483 ("[W]e think the rebuttable presumption approach ... is fairer."); *Bank of Chapmanville*, 406 S.E.2d at 65 ("For the victim of a commercially unreasonable disposition of collateral, the 'rebuttable presumption' rule comes to the rescue.").

presumption rule corrects this.<sup>105</sup> But in situations where the debtor has received no notice and as a result has lost the right to redeem or to be involved in the sale, other damages may be due.<sup>106</sup> In this latter situation, the rebuttable presumption rule is insufficient to compensate the debtor. The Code explicitly provides for damages to the debtor in section 9-507(1),<sup>107</sup> a provision the rebuttable presumption approach fails to recognize.

#### *D. The Siemens Credit Approach*

In *Siemens Credit Corp. v. Marvik Colour, Inc.*,<sup>108</sup> the Southern District of New York formulated a combination of the rebuttable presumption and setoff rules stating that this approach "best balances the interests at stake."<sup>109</sup> This approach most accords with the goals and policies of the Uniform Code because it both encourages the secured party to comply with section 9-504(3) and compensates the debtor for his damages, if any are proven.<sup>110</sup> "When both the debtor and the secured creditor are at fault, an appropriate remedy must compensate both without unduly punishing either."<sup>111</sup>

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<sup>105</sup> See, e.g., *Bank of Chapmanville*, 406 S.E.2d at 65 (explaining that rebuttable presumption rule favors debtors by presuming that collateral's fair market value equals amount of remaining debt).

<sup>106</sup> See *Rushton v. Shea*, 423 F. Supp. 468 (D. Del. 1976). The court stated that there are three purposes to the notice requirement: (1) it gives the debtor the opportunity to exercise the right of redemption; (2) it gives the debtor the opportunity to challenge the disposition of the collateral prior to the sale; and (3) the debtor is provided with the opportunity to seek out other purchasers for the collateral. *Id.* at 469.

<sup>107</sup> See *supra* note 86 (discussing exclusivity of remedies provided in § 9-507(1)).

<sup>108</sup> 859 F. Supp. 686 (S.D.N.Y. 1994).

<sup>109</sup> *Id.* at 692. The *Siemens* court stated that the New York Court of Appeals "would probably allow debtors to recover damages for lack of notice, thereby applying the setoff rule as well as the rebuttable presumption rule." *Id.* at 693. The Southern District couched its language in this manner because it was required to predict what the New York Court of Appeals would do if presented the issue. See *Murray v. Miner*, 74 F.3d 402, 404 (2d Cir. 1996) ("[B]ecause there is no New York authority on the issue before us, we must attempt to deduce what New York's highest court would decide.") (citations omitted); *Cunninghame v. Equitable Life Assurance Soc'y of the United States*, 652 F.2d 306, 308 (2d Cir. 1981) ("[T]he federal court must make an estimate of what the state's highest court would rule to be its law.").

<sup>110</sup> *Siemens Credit Corp.*, 859 F. Supp. at 692. The court concluded that under the combination rule, "the debtor is not required to pay any more or any less than it would have paid if notice had been given, and the secured party has incentive to provide notice of sale to the debtor." *Id.*

<sup>111</sup> *Dalton*, *supra* note 70, at 832.

In fact, many courts and at least one commentator have defined the rebuttable presumption rule to include the setoff rule.<sup>112</sup> This "combination" approach shifts the burden of proof to the creditor to prove the fair market value of the collateral in the event of alleged noncompliance;<sup>113</sup> if rebutted, the deficiency is then offset by the amount of damages, if any, the debtor has proven.<sup>114</sup> Adopting the rebuttable presumption rule without the setoff rule completely ignores the only New York Code provision which purports to discuss remedies for creditor noncompliance. As expressly held by the court in *Siemens Credit*, the application of the rebuttable presumption rule does not preclude the use of the setoff rule.<sup>115</sup>

Although the *Siemens Credit* approach has been criticized on the grounds that it may result in confusion in its application,<sup>116</sup>

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<sup>112</sup> See, e.g., *United States v. Whitehouse Plastics*, 501 F.2d 692, 695-96 (5th Cir. 1974) (stating that notwithstanding rebuttable presumption, "§ 9-507 clearly gives debtor the right to recover [damages]"), *cert. denied*, 421 U.S. 912 (1975); *Associates Fin. Servs. Co., Inc. v. DiMarco*, 383 A.2d 296, 302 (Del. Super. Ct. 1978) (concluding that debtor may offset against deficiency for any loss incurred); *Westgate State Bank v. Clark*, 642 P.2d 961, 969 (Kan. 1982) (holding that, under rebuttable presumption rule, debtor is entitled to setoff for damages incurred); *Holt v. Peoples Bank*, 814 S.W.2d 568, 571 (Ky. 1991) (concluding that damage caused to debtor should be deducted from deficiency judgment when using rebuttable presumption); see also *Formanek*, *supra* note 70, at 160-61.

[T]he secured party ... is not absolutely barred from a deficiency judgment ... [but] must rebut a presumption that the collateral was worth the amount of the debt by evidence other than the price received at the resale ... If the secured party is successful, he or she is awarded a deficiency judgment, offset by any damages the debtor may be entitled to under section 9-507(1).

*Id.*

<sup>113</sup> *Formanek*, *supra* note 70, at 160-61 (stating that "[t]he secured party bears the burden of proving that a deficiency would have resulted from a 'sale'" (emphasis added)).

<sup>114</sup> See, e.g., *Business Dev. Corp. v. Contestabile*, 413 S.E.2d 447, 448 (Ga. 1992) (describing debtor's right to set-off under rebuttable presumption rule); *Emmons v. Burkett*, 353 S.E.2d 908, 910 (Ga. 1987) ("Any loss suffered by the debtor as a consequence of the failure to give notice or to conduct a commercially reasonable sale is recoverable ... and may be set off against the deficiency."); *Bradford v. General Elec. Credit Corp.*, 359 S.E.2d 757, 758 (Ga. Ct. App. 1987) (recognizing debtor's right to set-off under rebuttable presumption rule); *Liberty Bank v. Honolulu Providoring Inc.*, 650 P.2d 576, 583 (Haw. 1982) (including debtor's right to setoff as part of rebuttable presumption rule); *Security Sav. Bank v. Tranchitella*, 592 A.2d 284, 290 (N.J. Super. Ct. App. Div. 1991) (describing manner in operations of rebuttable presumption rule).

<sup>115</sup> 859 F. Supp. at 693.

<sup>116</sup> E.g., *Associates Capital Servs. Corp. v. Riccardi*, 408 A.2d 930, 934 (R.I. 1979) ("To us, these precedents [which follow the combination rule] appear to chart a dan-

it is difficult to conceive of such a situation. Many courts presently incorporate the damages provision of section 9-507(1) into the rebuttable presumption rule. Thus, application of the combination rule seems to be occurring without courts realizing it. The real confusion stems from the continued application of three different rules not only in the four Departments of New York's Appellate Division,<sup>117</sup> but also throughout the entire country, with variations in result based on which portion of the statute has been violated.

Whereas the various rules presently applied by the New York courts promote confusion, the "combination approach" "provides an adequate deterrent to an improper sale on the part of a creditor, and sufficiently protects the debtor's interest, without arbitrarily penalizing the creditor."<sup>118</sup> Thus, New York should adopt the *Siemens Credit* approach, either legislatively<sup>119</sup> or judicially, to solve this problem once and for all.

### III. PROPOSED AMENDMENT TO NEW YORK'S UNIFORM COMMERCIAL CODE

"The aim of [Article 9] ... is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty."<sup>120</sup> In light of this asserted goal and the New York Court of Appeals' failure to address the issue, the proper way to deal with the split of authority in New York is by legislative amendment.<sup>121</sup> In 1983, New York's Law Revision

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gerous course because of the possible confusion that may result when determining which standard applies.").

<sup>117</sup> A close look at New York case law demonstrates the controversy between the three current approaches in dealing with creditor noncompliance. Courts do not always face the issue of debtor's damages, either because actual damage to the debtor is not substantial enough to warrant a counterclaim or because the case is before the court on a motion for summary judgment. At least two New York courts in the Fourth Department have addressed the issue of debtor's damages. See *S.M. Flickinger Co. v. 18 Genesee Corp.*, 71 A.D.2d 382, 386, 423 N.Y.S.2d 73, 76 (4th Dep't 1979) (adopting rebuttable presumption rule and allowing debtor to protect rights under § 9-507(1)); *Security Trust Co. v. Thomas*, 59 A.D.2d 242, 245, 399 N.Y.S.2d 511, 513 (4th Dep't 1977) (stating that while debtor cannot bar action for deficiency, debtor may recover damages).

<sup>118</sup> *Emmons*, 353 S.E.2d at 911.

<sup>119</sup> See *infra* Part III.

<sup>120</sup> N.Y.U.C.C. § 9-101 Official Comment at 291 (McKinney 1990).

<sup>121</sup> For example, in 1991, the Nebraska Legislature rejected the long standing absolute bar rule and amended Nebraska's Uniform Commercial Code to adopt the rebuttable presumption rule. Anderson, *supra* note 72, at 3.

Commission ("Commission") proposed an amendment to section 9-504.<sup>122</sup> In short, the Commission recommended that Article 9 be amended to apply the absolute bar rule to transactions involving \$5,000 or less and the rebuttable presumption rule to all others.<sup>123</sup> The reason for the distinction between transactions above and below \$5,000 is effectively to make creditor noncompliance an absolute bar in consumer transactions and apply the rebuttable presumption rule in commercial transactions.<sup>124</sup>

The Commission's proposal would have created a rule which was perhaps sound in theory, but would have been difficult to administer in practice. An arbitrary, bright-line rule based upon a dollar amount precludes courts from considering the individual transaction to determine if the behavior of the parties was proper. Thus, the consumer/commercial distinction should be considered in the first instance when evaluating whether the creditor acted in a commercially reasonable manner before the court has decided that the creditor has not complied with the statute.<sup>125</sup> Additionally, the Commission recommended the adoption of the absolute bar rule for consumer transactions which, as previously discussed, is an unduly harsh punishment for the creditor;<sup>126</sup> after all, it was the defaulting debtor who is to blame for this situation in the first place. An unduly harsh penalty may discourage the extension of credit, ultimately harming the same debtor that the New York Code wishes to protect. Lastly, the Commission's proposal directly contradicts section 9-507(2) which explicitly grants the creditor a deficiency judgment, thus injecting a new penalty into the New York Code that did not previously exist.

The codification of the rule adopted by the Southern District of New York in *Siemens Credit* would be a more equitable solution, and one which is more in line with the policies underlying the New York Code. Section 9-507 should be amended by adding

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<sup>122</sup> Memorandum of the Law Revision Commission Relating to the Right of a Secured Party to Recover a Deficiency Judgment Under Part 5 of Article 9 of the New York Uniform Commercial Code, [1983] N.Y. LAW REV. COMM'N REP., reprinted in [1983] N.Y. Laws 433 (McKinney).

<sup>123</sup> *Id.* at 472-73; accord Temm, *supra* note 66, at 22.

<sup>124</sup> See, e.g., Temm, *supra* note 66, at 22.

<sup>125</sup> See *supra* notes 51-59 and accompanying text (discussing requirement of commercial reasonableness).

<sup>126</sup> See *supra* notes 70-82 and accompanying text (discussing advantages and disadvantages of absolute bar rule).

a new subsection (3) to read as follows:

(3) If the secured party fails to comply with the requirements for disposition of collateral pursuant to section 9-504(3) of this Part, reasonable notification and a commercially reasonable sale, a rebuttable presumption will arise that the fair market value of the collateral is equal to the outstanding debt. In order to recover any deficiency judgment, the secured party must affirmatively prove (a) that the fair market value of the collateral is less than the outstanding debt and (b) the amount of the resulting deficiency (fair market value less the outstanding debt). If the secured party is successful in rebutting this presumption, the debtor shall be responsible for the resulting deficiency less any damages available under subsection (1) of this Section.

#### IV. CONCLUSION

The Uniform Commercial Code was adopted in New York in an attempt to simplify and alleviate the rigorous demands of the Uniform Conditional Sales Act. It was intended to create a uniform set of rules which judges and practitioners could apply with little trouble. With respect to a noncomplying creditor's right to a deficiency judgment, however, the New York Appellate Division has adopted three very different approaches among the court's four departments.

The Southern District of New York in *Siemens Credit Corp. v. Marvik Colour, Inc.* created a fourth approach which combines two already existing approaches. This "combination" approach best balances the competing interests of the creditor in recovering its investment, and the debtor in being protected from, and even compensated for, actions of unscrupulous creditors. Absent a decisive statement from the Court of Appeals of New York, the legislature should intervene by codifying the approach created in *Siemens Credit*. By so acting, the legislature will further the goal of the Uniform Commercial Code creating a *uniform* set of laws that can be relied upon to counsel their clients.

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